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TRILATERAL TIES: JAPAN, THE UNITED STATES AND THE PHILIPPINES

Summary

Bilaterally as well as trilaterally the Philippines has unique ties with Japan and the United States. But changes in the global political environment, including perceptions of a decreased Soviet threat and the needs of newly emerging democracies in Eastern Europe, have diverted attention from the Philippines. Yet the enormity of its problems, ranging from heavy foreign debt and political instability to poverty and hunger, demand particular attention from Japan and the United States.

Determining the most effective means of supporting this complex country has not been simple. A multilateral economic assistance program and negotiations for U.S. base rights in the Philippines have brought new challenges to the trilateral relationship. Domestic politics, too, will play a critical role in Japanese and U.S. relations with the troubled administration of Corazon Aquino.

Overview

Traditionally the United States has provided military support for the Philippines, while Japan has provided economic assistance, although both have economic as well as security interests there. This intertwined support tends to benefit the interests of both Japan and the United States as well as the host country, which plays a pivotal role in U.S. defense policy and, by extension, in U.S.-Japan security relations.

Although eased U.S.-Soviet relations have lessened the perceived threat of a major conflict in the Asian Pacific region, both Tokyo and Washington

emphasize the continuing importance of the 1960 U.S.-Japan Mutual Security Treaty for regional stability. Vice Foreign Minister Takakazu Kuriyama recently described the treaty as the "crucial pillar" for a continued American presence in Asia and the Pacific. U.S. Ambassador to Japan Michael Armacost also has stressed the importance of the U.S.-Japan security link for maintaining peace in a region where the activities of countries such as North Korea, Cambodia, the Soviet Union and China pose a question mark.

One of the most troubled spots is the Philippines, where a foreign debt of $26.6 billion and a 1990 budget deficit estimated at between $869 million and $1.7 billion strain a government beset by internal political turmoil and debilitating social conditions. While poverty has eased since the economic crisis accompanying the final years of Ferdinand Marcos' presidency, nearly half of the population still lives below the poverty line and harsh disparities between rich and poor have not diminished. Furthermore, bureaucratic inertia and poor infrastructure are hampering the country's ability to utilize the foreign aid and investment that could address these problems.

Relations in a Regional Context

Secretary of State James Baker reflected the importance the United States attaches to remaining a Pacific power in his June 1989 endorsement of an economic cooperation group for the Asia Pacific (see JEI Report No. 26B, July 7, 1989). Washington's objectives for the organization are to: demonstrate U.S. commitment to the region, "accompany" Japanese influence in Asia and the Pacific, secure allies in the push to open Japanese markets and create a counterweight to the European Community that could help open markets in Europe. In addition to supporting the Asian Pacific Economic Cooperation group, the United States, Japan and the Philippines also participate in private-sector initiatives aimed at promoting regional economic development, such as the Pacific Economic Cooperation Council and the Pacific Basin Economic Council.

While the basic elements of the Bush administration's Asian policy may not stray much from those emphasized by earlier administrations, political analysts have noted that the comprehensive nature of Mr. Baker's "new Pacific partnership" may reflect Washington's willingness to adapt its Asian Pacific policy to the political and economic changes that have occurred in the region in recent years. In addition to recognizing the need for increased coordination of American and Japanese policies, Mr. Baker encouraged Japan to assume a "broader international role with increased responsibility."[1] Ambassador Armacost further emphasized this tandem approach, saying, "The U.S. is expected to take the diplomatic lead in resolving regional and transnational problems, and Japan is an active partner in those endeavors."[2]

[1]Robert Pear, "U.S. Urges Japan to Assume Wider Global Responsibility," The New York Times, June 27, 1989, p. D1.

[2]"Cooperation Needed for Security, Armacost Says," The Japan Times, June 28, 1990, p. 3.

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Vice Foreign Minister Kuriyama has noted that the military check on Tokyo inherent in the U.S.-Japan security treaty facilitates the "acceptance of a larger political and economic role for Japan by its neighbors."[3] Reflecting a sensitivity to Japan's World War II occupation of the Philippines, some Japanese diplomats have said the impetus for Tokyo to take an increased political role in the Philippines should come from Manila, not Washington or Tokyo. They add, however, that there appears to be growing acceptance in the region for an increased leadership role for Japan.

American officials seem careful to limit their vision of an increased international role for Japan primarily to an economic role, with security and political responsibilities playing minor, if any, parts. While Capitol Hill long has pushed Japan to fulfill its international obligations, including military burdensharing, the most often recommended vehicle has been an increased percentage of gross national product provided as foreign aid.

In a recent speech urging Japan and other East Asian nations to contribute more to burdensharing, U.S. Ambassador to the Philippines Nicholas Platt noted that he did not see an enhanced regional security role for Japan, "but I certainly envisage cooperation" in promoting economic development in the area.[4] A staff member of the House Foreign Affairs Committee notes that demands for greater Japanese burdensharing voiced as recently as last year have mellowed as the United States considers reductions in its own overseas forces. Political analysts contend that an increased Japanese profile in the region could include providing Asian economies with technology and helping to spur their economic growth so they are better able to absorb imports from both Japan and the United States.

Japan's neighbors recognize, if only implicitly, that its significant economic presence in the region inevitably will lead to a greater political role. Alex Magno, a political commentator for the Manila Chronicle, noted, "Among the younger generation of Southeast Asians and Filipinos, we look at the long-term trend and see that we will have to eventually form a closer network of relationships, with Japan becoming the leader."[5] Nations in the region must join Japan in order to balance emerging trading blocs in other regions, Mr. Magno said.

Responses to a greater security role for Japan in the Asia Pacific area appear to be mixed. Hadi Soesastro, executive director of Indonesia's Center for Strategic and International Studies, has said, "Our view toward Japan has changed. We're no longer that threatened . . . and we think it is legitimate for Japan as a large power to have a role in the political and security affairs of the region."[6] Yet many nations, remembering the experience of Japanese occupation during World War II, are wary of increased Japanese military spending.

[3]Charles Smith, "Security Blanket," Far Eastern Economic Review, July 5, 1990, p. 12.

[4]"U.S. Wants More Help in East Asia," The Japan Times, May 19, 1990, p. 2.

[5]Cited in Rahti Rahil Dollahi, "Asean more receptive to political role for Japan," Japan Times, July 11, 1990, p. 3.

[6]Ibid., p. 3.

Most still feel it is important that Japanese military power be balanced by the presence of U.S. forces in the region. Thus, the potential U.S. withdrawal from bases in the Philippines or a perceived lessening of the American military commitment to the region are serious concerns for these nations. Others sense that, regardless of the U.S. military involvement, a greater Japanese economic presence will lead to a bigger political role for Tokyo.

Background of Japanese and American Involvement in the Philippines

The Philippines' still very bitter memories of Japanese occupation during World War II have tempered Tokyo's approach to that country, particularly in the security areas. Manila has voiced its concerns over Tokyo's commitment to defend the sea-lanes 1,000 nautical miles east and south of Japan -- a mission that brings the Self-Defense Forces within 200 nautical miles of Philippine shores. And suggestions by the Reagan administration that Japan share the costs of maintaining U.S. bases in the Philippines met with reservations in Manila as well as Tokyo.

Japan's vigorous economic expansion in Southeast Asia during the last three decades has had less apparent impact on the Philippines than on most of its neighbors. Trade with the Philippines expanded over this period along with direct investment, but Japanese business activities there took a back seat to what the private sector was doing in other countries in the region. Since Corazon Aquino became president in 1986, however, the Japanese government as well as the business community have increased their involvement in the Philippines. Paralleling Washington's efforts to bolster the new government, Tokyo has focused its policies on helping President Aquino stabilize the country's economy. Tokyo continuously has voiced strong support for the Aquino government, but, given a somewhat rocky relationship as well as regional sensitivities, it seems unlikely that Japan-Philippine relations will expand beyond the economic area.

Although the Philippines is America's oldest Pacific ally, the relationship has had its share of challenges. Early American involvement in the Philippines was fairly tenuous. Although the United States seized the Philippines in a move to gain the upper hand in the Spanish-American War, U.S. military installations established there were inadequate to counter any possible threat in the Pacific. Nor did the United States gain great economic benefits from its early presence in the Philippines. Historians suggest that America held onto the Philippines until it grew clear that colonial rule had not brought about the strategic and economic rewards Washington had envisioned.

In the 44 years since the country became independent, the Philippines has struggled to find its own identity. Some American observers believe that this struggle is partly behind the friction surrounding the recent talks to continue a U.S. presence at Clark Air Base, Subic Bay Naval Base and several smaller facilities in the Philippines. Shortly after the Philippines gained independence in 1946, the United States forged tight defense ties, including a mutual security treaty. But, with few exceptions, Philippine affairs have been low on the U.S. agenda until recent years.

In the early 1980s two events forced the United States to focus on the Philippines. The August 1983 assassination of Benigno Aquino, the leading opponent to the rule of then President Marcos, led the United States to take a

more critical view of the Marcos government. At the same time Washington recognized the growing threat to stability posed by the Communist Party of the Philippines and its military arm, the New People's Army. The insurgency, fueled by the Philippines' serious economic troubles, underscored the fact that President Marcos had not initiated the reforms necessary to check the movement. When Mr. Marcos' obvious attempts to win the February 1986 presidential election drew serious claims of fraud and a ground swell of support appeared for Mr. Aquino's widow, Corazon, U.S. policymakers hurriedly recognized that Mr. Marcos had become more of a liability than an asset. By backing Mrs. Aquino's administration, the United States took on greater responsibility for assisting the Philippines in its attempts to restore democracy.

Military Bases Agreement

Clark Air Force Base and Subic Bay Naval Base are the only large American military installations in the Pacific south of Japan and west of Hawaii. Among the most important offshore U.S. installations, the bases provide support for American military forces stretching from the Persian Gulf to Japan and Korea. They also are considered important to the security of sea and air lanes in the region. For the Philippines the bases have meant jobs for more than 70,000 Filipinos and a reported $1 billion a year in local expenditures. The presence of the U.S. bases also boosts foreign investors' confidence in the safety of establishing an enterprise in the country.

Originally leased under a 1947 agreement, the bases remain a symbol for many in the Philippines of U.S. domination. Extensive modifications in 1966 and 1977 as well as numerous minor revisions have resulted in base arrangements similar to what the United States has with many other allies, according to one American diplomatic source. But even with these amendments and U.S. accommodations that indicate the value past administrations have placed on the role of the Philippine bases in U.S. defense policy, their presence still rankles Manila's notion of sovereignty. The sensitivity of the base arrangements intensified during last December's coup attempt against Mrs. Aquino when President Bush responded to her requests for assistance by allowing Philippine-based U.S. military aircraft to intimidate rebel aircraft.

After lengthy negotiations the United States and the Philippines agreed in October 1988 to the terms governing the last phase of the 1947 base agreement, scheduled to expire in 1991. Most of the contention centered on the annual U.S. compensation package, which, at $481 million, was far short of the $1.2 billion originally requested by Manila. Debate over the amount of compensation resurfaced in May 1990 when the two countries met for exploratory talks on the future of the bases. The Aquino administration criticized what it viewed as a $222 million shortfall in U.S. aid allocated to the Philippines in FY 1990; it formally announced the termination of the current agreement as of September 1991. American officials only concede a $96 million shortfall (which they attribute to a congressional cut) and express frustration with Manila's emphasis on compensation.

Although U.S. officials state they would prefer to maintain the bases, Washington clearly is not willing or able to pay any cost. Policymakers have warned that negotiations will fail if Manila continues to raise the compensation issue. Mr. Bush announced during the talks, "If we're not wanted there, we're not going to be there." The president claims that the bases are no longer essential and that alternatives are being examined.

Adding tension to the talks is an apparently growing disillusionment with the Aquino administration among some on Capitol Hill. Moreover, the U.S. budget deficit is forcing legislators to look at aid to the Philippines with a more critical eye. Rep. David Obey (D, Wis.), in his role as chairman of the foreign operations subcommittee of the House Appropriations Committee, has voiced considerable skepticism about Manila's ability to utilize foreign aid. This concern has not yet reached critical levels in Congress. In June Rep. Obey's panel imposed limits on military aid to three countries that host U.S. bases, yet left uncut the administration's request for normal military and economic aid for the Philippines.

The Philippine Senate, which must ratify any new base agreement, appears to be easing its former antagonism to the bases, although as of July at least 15 of the 23 senators were on record as opposing renewal. Surveys conducted among Filipinos after the May talks showed that 79 percent of the respondents agreed that a termination notice should be served, although other public opinion polls indicate that a plurality favor a renewal of U.S. base rights with, perhaps, different conditions. The situation is complicated by uncertainty and divisiveness within the Aquino administration over the direction and the purpose of future talks. It appears, however, that Filipino policymakers have grown increasingly cognizant of the geopolitical context of the base decision as well as the serious domestic economic implications of a U.S. withdrawal.

The United States must balance the Philippine demands with the cost of relocating the bases. A 1988 congressional report concluded that it would be less expensive to move the bases than to pay the "unreasonable costs" being demanded by some in Manila. U.S. assertions that the Philippine bases are not irreplaceable may be partly a bargaining ploy, but dispersing the forces currently based there would require a significant transition period and would be extremely expensive. A recent Library of Congress study estimated that the cost of new facilities, the operational expenses involved and the required increased levels of mobile naval and air forces would amount to tens of billions of dollars.[7] Furthermore, the U.S. military presence in the Philippines gives America an important economic presence in the vibrant Pacific Rim, although suggestions that Singapore partly fill the breach would help maintain U.S. visibility in the region.

The implications of withdrawing American forces from the Philippines go beyond the costs to the United States. Washington obviously is aware of the signals such a withdrawal would send internationally, although given the current disarmament climate in Europe the signal may be muted. State Department officials stress that the United States will remain committed to the region even if its forces must be dispersed. In recent reports that the Bush administration and the government of Singapore were close to completing a military basing deal, a U.S. official noted that although access to facilities in Singapore did not constitute a permanent presence "it shows that we are still engaged in Asia."[8]

[7]Larry A. Niksch, "Philippines Under Aquino," Congressional Research Service Issue Brief, July 3, 1990, p. 3.

[8]Patrick E. Tyler, "U.S. Near Agreement to Base Aircraft, Ships in Singapore," Washington Post, July 6, 1990, p. A26.

Withdrawal from the Philippines would have particularly important implications for Japan. In an article in the Japan Economic Journal that appeared shortly after this spring's exploratory talks, U.S. chief negotiator Richard Armitage wrote, "Our handling of the facilities in the Philippines must be carefully coordinated with the government of Japan so that no damage ensues to our larger interests and need for forward deployments."[9] One proposed alternative to the bases in the Philippines is to increase reliance on U.S. bases in Japan.

The Foreign Ministry's Kuriyama says Japanese officials are concerned that a withdrawal of U.S. forces from both the Philippines and South Korea could result in U.S. influence in the region being "greatly curtailed, not only militarily but also politically and economically."[10] Some Japanese observers feel that a U.S. withdrawal from the Philippines could leave a vacuum in the region that neither China nor India can fill and that Japan is politically constrained from countering. They fear that the region could become more vulnerable to Soviet political influence and that Japanese and other foreign investments in the region would be left inadequately protected.

Internal Threats

The current volatility of the Philippines' domestic situation poses a variety of pitfalls to American and Japanese interests. President Aquino faces a slew of problems, including dissent within her own administration. She recently formed a nonpartisan political movement intended to recapture the popular support that swept her into power in 1986. One goal of the Kabisig (Linking Arms) Movement is to push through projects caught in a bureaucratic snarl and speed up the delivery of basic services. The initiative appears to reflect Mrs. Aquino's frustration with her country's entrenched political system; however, congressmen apparently have interpreted it as a direct attack.

A more immediate threat to her survival comes from the significant discontent in the army. President Aquino has survived several coup attempts led by members of the Philippine armed forces. Among their dissatisfactions are disagreement with the military power structure, disputes over President Aquino's policies toward the communist insurgency and frustration with the country's political structure and social conditions. Last December's coup attempt was coordinated by the Reform of Armed Forces Movement, a group formed in the early 1980s by an officer corps dedicated to bringing professionalism back to the military. Apparently helping RAM in the unsuccessful overthrow was the Young Officers Union, a new reform group in the military that is gaining influence quickly.

The communist insurgency led by the New People's Army, the military arm of the Communist Party of the Philippines, continues to pose a threat to the Aquino government, although official estimates show a decline in NPA forces since a 1986 peak. In some respects the rebels have become as much of a problem for Americans and Japanese working in the Philippines as for the government. The New People's Army has been linked to most of the 10 assassinations of

[9]Richard L. Armitage, "Security comes first as Asia enters world stage," Japan Economic Journal, May 26, 1990, p. 9.

[10]Smith, op. cit., p. 11.

Americans that have occurred since 1987. Philippine Communist Party statements have indicated that the insurgents are targeting American government personnel -- civilian as well as military -- and aid workers. The NPA claimed responsibility for killing two American airmen outside Clark Air Base before the May base talks and shortly afterward issued a statement warning that U.S. bases and American military personnel were targets for future attacks.

Tokyo's participation in the multilateral economic assistance program for the Philippines and the perceived anti-insurgent objectives of its aid programs have made Japan a leftist target, too. In 1989 the Philippine military revealed a letter reportedly written by the exiled founder of the Communist Party of the Philippines, who recommended warning Japan "against joining a U.S.-sponsored plan to buy off the U.S. bases' retention." Jose Maria Sison purportedly wrote the letter to a rebel colleague in 1988 and proposed cautioning Japan that any "improper" policy toward the Philippines would harm its interests there.

In recent months communist rebels have issued warnings that they would attack foreign-assisted projects that abet the government's anti-insurgency policy. In late May a private Japanese aid worker was kidnapped by suspected communist rebels. According to a Philippine military official, the rebels apparently believed the kidnap victim's sponsor -- the Organization for Industrial, Spiritual and Cultural Advancement -- is part of a campaign to weaken communist influence in rural areas through socio-economic projects.

In late June the United States announced its decision to pull Peace Corps volunteers out of the Philippines, apparently in response to information that the NPA had expanded its terrorist strategy to include them. Shortly afterward it was discovered that a Peace Corp volunteer had been abducted earlier in the month. The Japan International Cooperation Agency, which handles the technical assistance part of Japan's aid program, reportedly has urged the Japan Overseas Cooperation Volunteers, a Japanese version of the Peace Corps, to be particularly careful. An agency official has warned that the kidnapping of a JOCV volunteer would have a serious impact on Japan's aid program in the Philippines, although the agency apparently has no plans to withdraw. JICA reports indicate that approximately 75 JOCV volunteers were working in the Philippines in late 1989, mostly on agriculture, forestry and fishing projects. A rebel spokesman said the two American and the Japanese were kidnapped because they were viewed as assisting in the government's anti-insurgency plot.

In May a rash of bomb threats, bombings and assassinations in Manila led the government to deploy thousands of troops in the capital. The activities were attributed to suspected left-wing and right-wing rebels. The Japanese Embassy in Manila reportedly received several bomb threats this past spring. Philippine newspapers reported that Manila recently initiated investigations into the kidnappings of two other Japanese nationals and the murder of a Japanese businessman.

U.S. and Japanese Foreign Aid to the Philippines

Political discontent in the Philippines obviously is fueled by the country's economic struggles. In some respects the Philippine economy has made advances under President Aquino, particularly in light of the economic shambles left by Mr. Marcos. The economy's real growth rate over the last three years

has been 5 to 6 percent. The Aquino administration has been commended for not allowing inflation to run out of control, though it is a serious problem. In June inflation was 12.2 percent, down slightly from the previous month, but up almost 3 percentage points from the same time last year.

Furthermore, the Aquino administration's record of managing the country's foreign debt, which is pegged at $26.6 billion by the government, is respectable, and Manila recently has initiated a Brady Plan-type of debt reduction to tackle the problem (see below). Yet whether the Philippines' creditors will continue to pump money into the economy will depend on President Aquino's ability to deliver the promised economic reforms. The International Monetary Fund has expressed serious concerns about the Philippines' budget deficit, and future IMF credit disbursements are on hold pending a review of Manila's economic performance.

In early July President Aquino approved a 1991 national government budget totaling $10.7 billion. Approximately one-third of the budget, $3.3 billion, is earmarked for debt service, up from this year's figure of $2.7 billion. Acknowledging the strict economic reform guidelines from the IMF and other international lending bodies, Philippine Finance Secretary Jesus Estanislao has said the government would rely on increased tax collection efforts to narrow a budget deficit threatening to reach $2.8 billion in 1990. But the government also clearly is counting on bilateral and multilateral loans and foreign debt relief. Manila has indicated that it will lean more heavily on foreign sources to finance development projects in 1991.

The Philippines' budget problems have frustrated opportunities for economic growth -- the source of greater internal revenues -- partly because resources are not being directed effectively to much needed projects, such as infrastructure improvements. A prime example is the country's power shortage. Recent estimates indicate that brownouts alone may reduce economic growth by 1.1 percentage points this year. The earthquake that struck near Manila in July certainly will mean further setbacks for the country's growth.

The Philippines' economic troubles are most immediate for the 49 percent of the population that lives below the poverty line. In 1987 per capita gross national product was $546. Income maldistribution is severe; according to 1988 data, the top 20 percent of the population controlled more than 50 percent of the country's total income.

Multilateral Assistance Initiative - Both Tokyo and Washington have substantial foreign aid programs aimed at stabilizing the Philippines' shaky economic and political situation. Each government showed support for the new Aquino government with significant increases in aid. In late 1987 U.S. legislators urged the Reagan administration to initiate a multilateral economic assistance program -- dubbed the mini-Marshall Plan -- that would help the Philippines get back on its feet. After several months of negotiations 19 countries and seven international organizations pledged in July 1989 a total of $3.5 billion for the 1989-90 period. The program is expected to infuse the Philippine economy with $10 billion over five years, much of it through increased private investment and reduction of the country's official foreign debt.

The Multilateral Assistance Initiative is coordinated by the World Bank and serves as an umbrella under which the Philippines' major donor countries

have committed considerably expanded development assistance. Japan promised the largest amount, $1.6 billion for the 1989-1990 period. The figure includes $600 million in debt-reduction assistance, part of which represents the Export-Import Bank of Japan's previous commitment to parallel International Monetary Fund lending to the Philippines. Japan's MAI contribution represents an increase of about $300 million over its 1989 Philippine aid outlays. The United States pledged $1 billion over the life of the MAI project; the Bush administration requested $200 million in funding for 1990, but Congress appropriated only $160 million. Some of the U.S. contribution to the plan incorporates aid promised under the October 1988 base agreement.

Japanese officials have been insistent that the MAI package be free of military or political ties, particularly the issue of U.S. base rights. While Washington certainly does not deny that successful implementation of MAI will create a more favorable climate for the base talks, American officials have downplayed the military and the political implications of the program. Referring to the Philippine Assistance Program, which is how MAI is known in the Philippines, Ambassador Platt has argued, "You cannot negotiate for bilateral basing rights on other people's money and the PAP is mostly other people's money."[11]

MAI's purpose is to provide the Philippines with a firmer economic base -- one that will encourage private investment and, in turn, promote economic growth and democracy. The Philippine government has targeted five regions in the country for infrastructure developments that are intended to attract private investment in job- and income-creating enterprises. Beyond improving the country's infrastructure, the MAI package is intended to encourage economic policy reforms, particularly relaxation of regulations and privatization of public enterprises. Manila has established a coordinating council for PAP as well as a Committee on Official Development Assistance, which will coordinate all development assistance. It is hoped that these two organizations will focus funds on appropriate development needs as well as enable more effective absorption of the aid, long a problem for Manila.

Throughout the development of MAI, donors expressed concern over Manila's poor record in utilizing foreign aid in a timely and effective manner; they urged reforms aimed at pushing projects through the pipeline. In announcing Japan's MAI contribution, Tokyo emphasized the importance it placed on improvements in Manila's implementation capacity and noted that the future success of the plan would depend on advances in this area. Yet Philippine press reports indicate slow progress. The Philippine Congress reportedly hindered implementation of MAI by taking several months to adopt guidelines. Furthermore, projects proposed under MAI have been held up by lack of coordination between government agencies.

The MAI pledging session for 1991 will take place later this year, and U.S. officials expect that, with the basic elements in place, phase two will be more routine. Despite continued concerns about clogs in the pipeline, the principal MAI donors are unlikely to reduce their levels of support, according to Elliot Richardson, U.S. special MAI representative. The Bush administration requested $200 million as its second contribution, but the House has approved

[11]"Communist Rebels to Warn Japan Not to Support Aid Plan," Kyodo News Service, August 11, 1989.

only $160 million, the same amount appropriated for this year. It remains to be seen how much the Senate -- which is considering $1 billion less for overall FY 1991 foreign aid -- will vote. Tokyo's suspected unhappiness with Manila's implementation of a development strategy has prompted rumors in the Philippines that Japan had declined to be the next pledging session host. But American and Japanese officials say only that the site has not been determined. The Foreign Ministry continues to express support for MAI. The Philippines' finance secretary has said that donor countries, including the United States and Japan, have promised not to scale down their MAI commitments.

Meanwhile, Philippine press reports complain that the only significant expenditure of MAI funds to date has been debt alleviation. In February MAI funds provided most of the money for a buy-back operation, which retired $1.3 billion worth of foreign debt (see below). Tokyo recently announced, however, that it had pledged loans for a project intended to boost the agro-industrial development of the Negros and the Panay Islands. Japan's contribution includes cofinancing with international banks. Several donor nations and international organizations reportedly have committed funding for the project.

Bilateral Aid Programs - In addition to its MAI contribution the United States provides substantial foreign aid linked to its base rights in the Philippines. In the October 1988 base agreement the Reagan administration pledged its "best efforts" to secure $481 million of aid for the FY 1990-FY 1991 period. Capitol Hill cut base-related aid for FY 1990 by $96 million, a "shortfall" decried by Philippine negotiators, but with special funds pledged under MAI total FY 1990 aid authorized for the Philippines could reach $545 million.

The American aid program for the Philippines includes economic support funds, a special category of economic assistance for countries with particular economic, political or military significance to the United States. In contrast to development aid -- which is aimed at achieving long-term development objectives -- economic support funds focus on short-term economic stabilization and budget concerns.

Despite the growing geographical diversification of Japan's rapidly expanding assistance program, Asia still receives more than 60 percent of its foreign aid. Part of the explanation is that Tokyo has increased its aid to areas with strategic significance in recognition of the importance of supporting economic stability in such countries and, in some respects, in line with its burdensharing initiatives. Many of these countries are in Asia. Thus, the Philippines long has been among the top recipients of Japan's foreign aid; in 1987 and 1988 it was the third-largest recipient. Furthermore, Japan is the largest source of aid for the Philippines. In 1987 Japan provided 53.7 percent of the total foreign aid allotted to the Philippines by members of the Development Assistance Committee of the Organization for Economic Cooperation and Development.

According to the Ministry of Foreign Affairs, Japanese loans and grants in 1988 supported such projects as infrastructure development, teacher training and disaster assistance. In addition, approximately $1.8 million went to debt relief. Although some Japanese aid projects have been criticized as environmentally insensitive, Japanese aid officials have said that recently adopted environmental guidelines will steer Japanese aid away from projects suspected of causing pollution.

Loans have comprised the overwhelming portion of Japan's official development assistance to the Philippines in recent years, a trend that may change as Japan boosts its efforts to increase the grant element of its ODA. Last year the Overseas Economic Cooperation Fund, the soft loan arm of Japan's foreign aid program, committed to a $750 million loan package to the Philippines. This year the Philippines has requested a yen loan package worth $1.9 billion. The funds are to be used on such high-priority projects as flood control, rural electrification, irrigation and transportation.

OECF also plans to provide most of the $358 million the Philippines will receive as its share of a $2 billion loan package aimed at helping members of the Association of Southeast Asian Nations develop their industrial bases. Former Prime Minister Noboru Takeshita unveiled the Asean-Japan Development Fund in 1987; it is part of Japan's effort to recycle $20 billion of its current account surplus to the Third World through aid. The Philippines will receive about $275 million in loans from OECF, with the remainder coming from the Export-Import Bank of Japan.

Complementing official development assistance, Japan also provides credits to the Philippines through Ex-Im. In May the bank agreed to make a $300 million loan to the Philippine government to finance the import of goods and services. The credit reportedly will be extended in parallel with a financial-sector adjustment loan from the World Bank. The first tranche of Japanese funds is expected to be offered in August; the release of the remaining funds will hinge on whether the Philippine government carries out banking reforms sought by the World Bank and the Ex-Im Bank.

In August 1989 the Philippines became the second country to take advantage of a new debt initiative introduced earlier in the year by Treasury Secretary Nicholas Brady (see JEI Report No. 33B, August 25, 1989). The negotiations between Manila and its international lenders held special interest for Tokyo since, by most accounts, Japanese banks have more money at stake in the Philippines than American banks.

The Aquino government, hoping to attract new funds to finance economic growth, strayed slightly from the original concept of the Brady Plan by opting for an accord that emphasizes fresh loans over debt reduction. The plan combines $1 to $1.2 billion of new lending at favorable rates, cash buy-backs of loans at rates to be determined relative to market rates and a 0.0625 percentage-point reduction in interest rates on much of the existing debt. Treasury officials have pointed out that the fresh-loan emphasis of the agreement is well-suited to the Philippines because most of its debt is owed to governments and international lending institutions, which generally do not agree to loan write-downs. The debt buy-back element included in the financing plan, along with several other debt-reduction schemes and currency adjustments, have enabled the Philippines to reduce its external debt by nearly $1.5 billion since last December.

Although some parts of the international financial community have called for a greater emphasis on debt relief in the hopes of getting around Manila's troublesome flow of funding, many believe such a policy would create a dangerous precedent. According to an OECF representative, Japan is unlikely to shift its focus to debt relief rather than development assistance for the Philippines.

In early July the Philippines and the International Monetary Fund reached an agreement on a revised economic program that will scale down the country's 1990 real GNP growth target to between 4.8 and 5.2 percent. The Philippines agreed to target a higher rate last year in return for a three-year IMF credit worth nearly $1.2 billion. The IMF executive board is expected to review the program later this summer and decide whether the Philippines has undertaken sufficient economic reforms to merit the release of the third year of funding. If IMF approval is withheld it will have serious consequences; foreign government and commercial bank creditors will balk at making further deals with Manila, according to American and Japanese aid officials. The revised economic program includes proposals to cut tariffs and otherwise liberalize trade, speed up privatization of government-run businesses and raise additional taxes. Manila has admitted that the reforms will boost inflation, keeping it above 13 percent for the next few months. Officials hope, however, to bring the inflation rate down to an annual rate of 9.5 percent by the end of the year.

Trade and Investment

One of Manila's economic objectives for the Philippines is to become a newly industrialized economy like South Korea, Taiwan, Hong Kong and Singapore by the 21st century. Yet the Philippines' economic expansion has lagged compared to that of other Asean members, particularly Singapore and Thailand. In 1988 President Aquino expressed concerns that the disparate economic growth of Asean countries could weaken economic and possibly political cooperation among the six member nations (Indonesia, Malaysia, Thailand, Singapore, the Philippines and Brunei). Although uneven development threatens to put the Philippines at a disadvantage in any future Asean trading bloc, the country has benefited as an investment site for its neighbors, particularly the NIEs. Hong Kong and Taiwan have been among the top investors in the Philippines in recent years; in 1989 capital from the two represented 30 percent of total corporate investment in the country.

In addition, the Philippines stands to gain from the four NIEs' December 1988 loss of Generalized System of Preference benefits for exports of selected products shipped to the United States. In 1987 the Philippines ranked last among its Asia Pacific counterparts in taking advantage of this preferential tariff treatment. This has led economic analysts to predict that some countries may shift their operations from the NIEs to the Philippines in order to fully exploit GSP benefits.

While Japan's trade with East Asia is growing rapidly, some analysts see America's economic involvement in the region as beginning to slow. IMF figures indicate that the Philippines, at least, still relies more on U.S. transactions, conducting 27.4 percent of its two-way trade in 1988 with the United States and 18.5 percent with Japan. Machinery and equipment constitute Japan's top exports to the Philippines, followed by steel and chemicals. Its primary imports from the Philippines are bananas, fish and metal ores and scrap -- a marked contrast with the list of U.S. imports, which is headed by semiconductors and clothing. Manila has pushed Japan to open its markets further in ways that would benefit Philippine products and to assist with export product development, but Japan's exports to the Philippines generally increased at a faster rate than its imports in the second half of the 1980s.

As the developers of MAI recognized, private investment is essential for continued economic growth in the Philippines. Yet it is not clear whether the opportunities for investment in the Philippines outweigh the risks and frustrations. Investors cite the Philippines' strategic location, a large, well-trained English-speaking labor force and a fairly substantial domestic market as incentives for investment. Yet according to Mark Blacker, president of the American Chamber of Commerce in the Philippines, some foreign investors are being driven away from the Philippines by inadequate infrastructure (including electricity), discriminatory legislation, security threats and bureacratic inertia. Among the most frustrating regulations for offshore investors are rules limiting foreign ownership of a company to 40 percent and leases to a maximum of 25 years. Investors have appealed to the government to revise the regulations, but so far Philippine legislators have done little but promise change. The Philippine investment climate particularly pales in comparison to that of its Southeast Asian neighbors.

Foreign investment registered with the Central Bank of the Philippines in the first quarter of 1990 was 62 percent higher than in the January-March 1989 period -- $47.9 million compared to $29.5 million. Yet foreign investors withdrew $98 million from the Philippines between January and April 1990, a sharp contrast to total 1989 withdrawals of $95 million. Although Philippine bank sources blame the investment flight to nervousness following the December 1989 coup attempt, many observers believe that legal and logistical hassles are more to blame for foreign investors' cold feet than political threats.

While American businesses that have been in the Philippines for decades appear to be doing well, U.S. investors have directed little new money into the country in recent years. In 1989 the United States slipped from being the biggest investor there to the third largest. On the positive side two American companies -- Bechtel Group and American Express Co. -- have joined a consortium that plans to develop a light industry and science park south of Manila. John Callebaut, director of the Washington-based U.S.-Philippine Business Committee, notes that the type of development projects encompassed under MAI "are certainly the type where U.S. companies are competitive in terms of supplying equipment and services." However, several American corporations have relocated to nearby countries. In July Caltex Corp. pulled out of a $340 million power plant project on which it had spent two and a half years negotiating and Ford Motor Co. canceled plans to build a $150 million automotive audio equipment plant.

Japanese direct investment in the Philippines has increased rapidly in recent years. According to the Philippines Department of Trade and Industry, Japan eclipsed the United States and Taiwan and became the biggest investor in the country in 1989. Japan's ambassador to the Philippines recently described Japanese investors as "still positive but cautious." Most Japanese investment has gone into the manufacturing sector; investments there represented more than 82 percent of the 1989 total, followed by 8.8 percent in the service sector, according to Philippine sources. As of March 1989 an estimated 130 Japanese firms were operating in the Philippines through link ups such as joint ventures. Two electronics manufacturers were among the largest Japanese investors at the time -- Uniden Corp. and Matsushita Electric Industrial Co., Ltd.

The Philippines also was the first client of the Japan International Development Organization -- established by Keidanren (Japan Federation of Economic Organizations) in 1989 to encourage private-sector involvement in Third

World development. The business group's decision to make the Philippines its test case reportedly was spurred by Japanese investors' complaints about the difficulties of investing there. A JAIDO mission to the Philippines in May 1989 netted four major investments, but as an indication of the difficulties some foreign investors face in the Philippines, two industrial parks involving Japanese investors have been bogged down by interdepartmental land-use disputes.

As the Philippines tries to shift to products that will supply more added value, its imports have climbed, rising 27 percent in the first quarter of 1990, for example. Analysts note that this jump was partly due to an increase in purchases of power-generating equipment and other capital goods, but imports of consumer goods also rose sharply in the period. Philippine exports grew too, by 9 percent, which included rises in its leading exports, electronic goods and clothing. But analysts see power shortages and rising production costs as imperiling the country's manufacturing sector, while slumping world prices for the Philippines' agricultural and mineral products could boost its trade deficit.

Outlook

In many ways the upcoming months will be a critical period for the Philippines. Washington's uneasiness with the political and economic situations in the country appears to be growing. According to one congressional staff member, "President Aquino's halo has somewhat vanished." Internationally many believe the chance of another coup attempt is very high. Much will depend on the outcome of base negotiations covering the post-1991 period to be held later this year. Japanese and American policymakers and investors considering their potential involvement in the Philippines will be weighing both the results of the talks and Manila's success in carrying out crucial economic reforms.

For further information, contact Margo Grimm.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

APPENDIX

Table 1: Japan's Exports to Noncommunist Asian Countries, 1985-89

(in millions of dollars, f.o.b. value basis)

	1985	1986	1987	1988	1989
South Korea	$7,097	$10,475	$13,229	$15,441	$16,561
Taiwan	5,026	7,852	11,346	14,354	15,421
Hong Kong	6,509	7,161	8,872	11,706	11,526
Singapore	3,861	4,577	6,008	8,311	9,239
Thailand	2,030	2,030	2,953	5,162	6,838
Malaysia	2,168	1,708	2,168	3,060	4,124
Indonesia	2,173	2,662	2,990	3,054	3,301
Philippines	937	1,088	1,415	1,740	2,381
India	1,596	2,099	1,957	2,082	2,018
Noncommunist Asia Total	33,248	41,788	52,982	67,109	73,516
Total Exports	175,638	209,151	229,221	264,917	275,175

Source: Japan Tariff Association

Table 2: Japan's Imports from Noncommunist Asian Countries, 1985-89

(in millions of dollars, c.i.f. value basis)

	1985	1986	1987	1988	1989
South Korea	$4,092	$5,292	$8,076	$11,811	$12,994
Taiwan	3,386	4,691	7,128	8,744	8,979
Hong Kong	767	1,074	1,561	2,109	2,219
Singapore	1,594	1,463	2,048	2,339	2,952
Thailand	1,027	1,391	1,796	2,751	3,583
Malaysia	4,330	3,846	4,772	4,710	5,107
Indonesia	10,119	7,311	8,427	9,497	11,021
Philippines	1,243	1,221	1,353	2,044	2,059
India	1,189	1,297	1,530	1,804	1,978
Noncommunist Asia Total	30,264	29,489	38,627	47,802	52,906
Total Imports	129,539	126,408	149,515	187,354	210,847

Source: Japan Tariff Association

Table 3: U.S. Exports to Noncommunist Asian Countries, 1985-89*

(in millions of dollars, f.a.s. value basis)

	1985	1986	1987	1988	1989
South Korea	$5,956	$6,355	$8,099	$11,290	$13,478
Taiwan	4,700	5,524	7,413	12,131	11,323
Singapore	3,476	3,380	4,053	5,770	7,353
Hong Kong	2,786	3,030	3,983	5,691	6,304
Malaysia	1,539	1,730	1,897	2,139	2,875
India	1,642	1,536	1,463	2,498	2,463
Thailand	849	936	1,544	1,964	2,292
Philippines	1,379	1,363	1,599	1,880	2,206
Indonesia	795	946	767	1,056	1,256
Noncommunist Asia Total	24,529	26,099	31,985	46,061	n.a.
Total Exports	218,828	227,159	254,122	322,426	364,350

*Excludes Japan.

Source: Department of Commerce

Table 4: U.S. Imports from Noncommunist Asian Countries, 1985-89*

(in millions of dollars, c.i.f. value basis)

	1985	1986	1987	1988	1989
South Korea	$10,713	$13,497	$17,991	$21,209	$20,593
Taiwan	17,761	21,252	26,407	26,256	25,628
Singapore	4,412	4,884	6,395	8,226	9,183
Hong Kong	8,994	9,474	10,490	10,810	10,238
Malaysia	2,399	2,534	3,053	3,853	4,927
India	2,478	2,465	2,725	3,167	3,551
Thailand	1,543	1,873	2,387	3,424	4,635
Philippines	2,334	2,150	2,481	2,906	3,308
Indonesia	4,933	3,675	3,719	3,494	3,874
Noncommunist Asia Total	56,861	63,375	77,608	85,438	n.a.
Total Imports	361,626	387,082	424,082	459,542	492,870

*Excludes Japan.

Source: Department of Commerce

Table 5: Japan's Direct Investment Position in Asia, Yearend FY 1985-FY 1989

(in millions of dollars; gross value; notification basis)

	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Indonesia	$8,423	$8,673	$9,218	$9,804	$10,435
Hong Kong	2,931	3,433	4,505	6,167	8,066
Singapore	2,269	2,571	3,065	3,812	5,715
South Korea	1,683	2,118	2,765	3,248	3,854
Thailand	760	884	1,134	1,992	3,268
Malaysia	1,125	1,283	1,446	1,834	2,507
China	287	513	1,740	2,036	2,474
Taiwan	761	1,051	1,419	1,791	2,285
Philippines	892	913	985	1,120	1,322
Asia Total	19,463	21,790	26,658	32,227	40,465
Total Investment	83,649	105,970	139,334	186,356	253,896

Source: Ministry of Finance

Table 6: U.S. Direct Investment Position in Asia, Yearend 1985-89*

(in millions of dollars, net book value basis)

	1985	1986	1987	1988	1989**
Hong Kong	$3,295	$3,912	$4,390	$5,244	$5,853
Indonesia	4,475	3,217	3,050	2,925	3,696
Singapore	1,874	2,256	2,462	2,290	2,213
Taiwan	750	869	1,280	1,622	1,949
South Korea	743	782	1,003	1,501	1,889
Philippines	1,032	1,299	1,220	1,511	1,682
Thailand	1,074	1,078	1,274	1,132	1,279
Malaysia	1,140	1,021	1,019	1,135	1,098
China	311	167	207	310	n.a.
Asia Total	15,400	15,332	16,694	18,515	20,991
Total Investment	230,250	259,800	307,983	333,501	373,436

*Excludes Japan.
**Preliminary.

Source: Department of Commerce

Table 7: Japan's Official Development Assistance to the Philippines, 1984-88*

(in millions of dollars)

	Grants			
	Grant Aid	Technical Cooperation	Loans	Total
1984	$26.4	$31.3	$102.4	$160.1
1985	39.9	29.8	170.3	240.0
1986	41.1	39.3	357.6	437.9
1987	66.9	44.9	267.6	379.4
1988	70.4	60.7	403.6	534.7

*Net disbursement basis.

Source: Ministry of Foreign Affairs

Table 8: U.S. Foreign Assistance to the Philippines, FY 1986-FY 1991

(in millions of dollars)

Fiscal Year	Loans	Grants	Total
1986	$56.3	$447.9	$504.2
1987	--	399.3	399.3
1988	--	414.5	414.5
1989	--	314.2	314.2
1990	--	504.4	504.4
1991 requested	--	647.1	647.1

Fiscal Year	Development Aid	Other Economic Aid	Food Aid	Economic Support Funds	Military Aid	Total
1986	$51.4	$4.4	$43.3	$300.0	$105.1	$504.2
1987	17.6	4.8	39.0	235.1	102.8	399.3
1988	40.0	--	57.9	189.0*	127.6	414.5
1989	46.7	--	15.9	124.0	127.6	314.2
1990	46.7	160.0**	30.9	124.0	142.7	504.4
1991 request	55.0	200.0**	32.1	160.0	200.0	647.1

*Includes an additional $50 million for agrarian reform.
**Funds for the Multilateral Assistance Initiative.

Source: Compiled by Library of Congress from Agency for International Development data.

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